



UNDER SECRETARY OF DEFENSE

1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

MAY 02 2022

The Honorable James M. Inhofe
Ranking Member
Committee on Armed Services
United States Senate
Washington, DC 20510

Dear Senator Inhofe:

Thank you for your support of the Department and your concern about the impact of inflation on our buying power and our ability to deliver the capabilities funded in our budget. We are responding to your March 17, 2022 letters to us seeking clarity on the impact of inflation on the Department of Defense (DoD). Because the Department employs consistent practices across the enterprise, we are providing a joint response.

The Department paid close attention to the issue of inflation and addressed it within our Fiscal Year 2023 budget submissions to the best of our ability. We did our homework on what was needed to account for inflation, and built that into our pricing of the goods and services we buy from the private sector and our compensation costs.

The Department worked closely with the Office of Management and Budget on this, and Secretary Austin engaged directly with, and had the full support of, the President on protecting DoD's buying power. The President's FY2023 budget added \$20 billion per year in additional funding to protect our buying power and account for increased compensation expenses.

We do not control the variables in the global or U.S. economies that drive markets or prices. Most notably, Russia's unprovoked invasion of Ukraine, which occurred subsequent to the formulation of the FY2023 budget, has spiked global energy prices. We recognize the economic picture will continue to evolve and that the situation today differs not only from the picture last fall but that it will continue to evolve and that today's data offer us only limited insight into what will be happening during FY2023.

The Department recognizes adjustments may be needed as prices fluctuate. The enhanced DoD topline in our FY2023 request, and the reprogramming authority that Congress provides us, are our primary tools to ensure our priority investments remain on track. As Secretary Austin has stated, if he believes additional resources or flexibility is needed to deliver the capability the nation needs, the Department will work with the President and the Congress on those issues.

We have addressed your specific inflation-related questions in the attachment to this letter. The Department will continue to work with you to address any further concerns.

A similar letter is being sent to Representative Mike D. Rogers, Ranking Member of the House Committee on Armed Services.



Christine Wormuth
Secretary of the Army



Michael McCord
Under Secretary of Defense
(Comptroller)/CFO



Carlos Del Toro
Secretary of the Navy



Frank Kendall
Secretary of the Air Force

Attachment:
DoD Responses to Inflation Questions

Attachment: Responses to Sen. Inhofe and Rep. Rogers' Inflation Questions

1. **What are the inflation baselines from which DOD is measuring actual inflation in fiscal years 2021 and 2022?**
 - a. **Please provide this planning guidance.**

Answer: Consistent with section 257 of the Balanced Budget and Emergency Deficit Control Act of 1985 (2 U.S.C. 907), the Department uses the Gross Domestic Product (GDP) chain-type price index as the inflation baseline for measuring the changes from year to year and for building budget estimates. The *GDP*, which measures the value of the final goods and services produced in the U.S., has proven to be the most useful index, because it reflects the types of purchases the Department makes – *large end items and contracted services*. The Consumer Price Index (*CPI*) is less useful for DoD, since it measures changes in prices for consumer goods for a market basket of *consumer goods and services*.

The table below shows the estimated GDP (chained) price index growth rates in FY 2021 and FY 2022, which were used for building the FY 2022 and FY 2023 budget estimates. Of particular importance is that the FY 2023 President's Budget request incorporates the higher prices paid for DoD purchases in FY 2021 and FY 2022. What remains unknown is what the actual GDP price index will reflect in 6 months, the start of FY 2023, and the rest of the fiscal year.

GDP Price Index Changes from FY 2021 to FY 2022 used for Budget Estimates		
	FY 2021	FY 2022
Estimated GDP Price Index for building the FY 2022 President's Budget Request	1.7%	1.8%
Estimated GDP Price Index for building the FY 2023 President's Budget Request	3.1%	3.9%

The GDP price index, as described above, is the best index applicable to the Department as a whole, and in particular to the broad range of goods and services we buy from the private sector. In addition, the Department uses a number of specialized indices for certain items, such as the purchase of fuel and for some aspects of compensation of service members. The compensation-related indices are described in the response to question 20.

2. **To what extent has the Department captured the actual inflation differences, by appropriations account or other category of measure, in relation to the benchmarks in question 1?**
 - a. **Please provide the details of such differences.**

Answer: The below table captures the budgetary impacts of inflation by appropriation and by Military Department for FYs 2021, 2022, and 2023 in relation to changes in the estimated GDP price index percentages in question 1.

Cost Growth associated with changes in GDP Price Index from FY22 PB estimate vs. FY23 PB estimate					
			2021	2022	2023
		FY22 President's Budget (PB) GDP Assumptions	1.7%	1.8%	1.9%
		FY23 President's Budget (PB) GDP Assumptions	3.1%	3.9%	2.2%
Account Code	Dept Code	Appropriation Title	Budgetary Effects (Fiscal Year, \$ in Thousands)		
			2021	2022	2023
2020	A	O&M, Army	1,094,144	1,382,607	1,450,311
2080	A	O&M, Army Reserve	50,130	72,632	78,506
2065	A	O&M, Army Nat'l Guard	129,981	180,608	191,169
0810	A	Environmental Restoration, Army		7,274	7,134
2099	A	Counter-ISIL Iraq Syria T & E	22,614	19,383	19,692
2031	A	Aircraft Procurement, Army	140,048	104,967	94,473
2032	A	Missile Procurement, Army	141,916	133,537	125,784
2033	A	Proc of W&TCV, Army	127,268	145,420	131,103
2034	A	Procurement of Ammo, Army	98,571	80,907	92,451
2035	A	Other Procurement, Army	312,917	329,886	256,092
2040	A	RDT&E, Army	354,141	441,917	448,859
2050	A	Military Construction, Army	34,365	31,465	32,695
2086	A	Military Construction, Army Reserve	3,196	2,443	3,631
2085	A	Military Construction, Army Nat'l Guard	14,562	9,684	10,807
051601	A	DoD Base Closure, Army	4,272	2,386	2,461
0720	A	Fam Hsg Constr, Army	4,788	3,761	6,156
0725	A	Fam Hsg O&M, Army	7,818	12,618	13,401
Total Department of the Army			2,540,731	2,961,495	2,964,725
1804	N	O&M, Navy	944,989	1,493,511	1,556,975
1806	N	O&M, Navy Reserve	21,160	33,884	36,368
0810	N	Environmental Restoration, Navy		10,804	13,063
1506	N	Aircraft Procurement, Navy	638,637	613,354	600,616
1507	N	Weapons Procurement, Navy	151,808	157,742	177,764
1508	N	Procurement of Ammo, Navy & MC	30,014	37,013	34,650
1611	N	Shipbuilding & Conv, Navy	672,039	847,903	969,713
1612	N	National Sea-Based Deterrence	147,501		
1810	N	Other Procurement, Navy	345,545	403,124	362,884
1319	N	RDT&E, Navy	339,268	488,267	526,711
1205	N	Military Construction, Navy & MC	72,043	89,277	137,649
1235	N	Military Construction, Navy Reserve	2,589	2,705	1,103
051602	N	DoD Base Closure, Navy	5,163	3,766	3,534
051002	N	BRAC, Navy 1990	266		
051202	N	FY 2005 BRAC, Navy	333		
0730	N	Fam Hsg Constr, Navy & MC	1,580	2,924	12,262
0735	N	Fam Hsg O&M, Navy & MC	7,885	10,539	10,438
4557	N	National Defense Sealift Fund	10,834		
1106	N	O&M, Marine Corps	149,104	235,773	223,465
1107	N	O&M, MC Reserve	6,388	9,276	9,869
1109	N	Procurement, Marine Corps	89,902	113,302	114,452
Total Department of the Navy			3,637,048	4,553,164	4,791,516

Cost Growth associated with changes in GDP Price Index from FY22 PB estimate vs. FY23 PB estimate					
			2021	2022	2023
		FY22 President's Budget (PB) GDP Assumptions	1.7%	1.8%	1.9%
		FY23 President's Budget (PB) GDP Assumptions	3.1%	3.9%	2.2%

Account Code	Dept Code	Appropriation Title	Budgetary Effects (Fiscal Year, \$ in Thousands)		
			2021	2022	2023
3400	F	O&M, Air Force	930,652	1,349,439	1,373,883
3740	F	O&M, AF Reserve	40,820	64,299	70,293
3840	F	O&M, Air Nat'l Guard	110,065	163,604	172,590
0810	F	Environmental Restoration, AF		10,931	11,432
3010	F	Aircraft Procurement, AF	688,064	589,433	564,679
3020	F	Missile Procurement, AF	58,706	78,406	85,217
3011	F	Procurement of Ammo, AF	43,986	29,951	35,181
3080	F	Other Procurement, AF	59,334	151,982	71,358
3600	F	RDT&E, Air Force	615,569	976,602	1,035,204
3300	F	Military Construction, Air Force	37,473	79,201	78,392
3730	F	Military Construction, AF Reserve	1,771	2,954	2,058
3830	F	Military Construction, Air Nat'l Guard	3,378	7,449	5,412
051603	F	DoD Base Closure, AF	4,721	3,807	3,901
0740	F	Fam Hsg Constr, AF	4,701	4,359	8,644
0745	F	Fam Hsg O&M, AF	8,307	9,816	9,481
3410	F	O&M, Space Force	55,044	113,956	128,402
3022	F	Procurement, Space Force	75,372	102,921	129,046
3620	F	RDT&E, Space Force	274,453	400,270	465,578
Total Department of the Air Force			3,012,416	4,139,380	4,250,751
0100	D	O&M, Defense-Wide	544,293	823,087	869,131
0107	D	Office of the Inspector General	3,510	5,072	5,710
0104	D	US Court of Appeals for Armed Forces, Def	158	233	235
0105	D	Drug Interdiction & CN		22,926	23,946
0838	D	Support International Sport Comp	19		377
0810	D	Environmental Restoration, DW		318	324
0811	D	Environmental Rest., Formerly Used		7,918	8,262
0134	D	Cooperative Threat Reduction	12,215	8,971	9,322
0390	D	Chemical Agents and Munitions Destruction, Defen	28,747	38,648	36,961
0300	D	Procurement, Defense-Wide	191,543	184,232	152,453
0350	D	Guard and Reserve Equipment	35,138		
0360	D	Defense Production Act Purchases	4,217	12,299	12,593
0400	D	RDT&E, Defense-Wide	578,860	748,728	713,171
0460	D	Operational Test and Evaluation	6,726	7,885	8,469
0500	D	Military Construction, DW	65,786	60,709	60,537
0804	D	NATO Security	5,610	7,489	7,639
051604	D	DoD Base Closure, DW	91	147	109
051204	D	FY 2005 BRAC, DW	10		
0834	D	Fam Hsg Improvement	1,916	220	234
493004	D	Working Capital Fund, DeCA			17,601
Total Defense-Wide			1,478,839	1,928,882	1,927,074
Total Department of Defense			10,669,034	13,582,921	13,934,066

- Adjustment to WCF, DeCA funding was not calculated until FY 2023.
- Excludes National Intelligence Program funding.

3. **Has DOD promulgated internal guidance regarding the collection of actual inflation-related data in fiscal years 2021 and 2022 to DOD components and/or contractors?**
- a. **If so, what types of data elements are suggested or required to be collected?**
 - b. **If so, does the guidance included qualitative data in addition to quantitative data?**
 - c. **If so, please provide this internal guidance and a summary of the data collected.**

Answer: The Department promulgates internal inflation guidance to formulate President's budget estimates, but does not promulgate guidance to collect actual inflation-related data during the year of execution or for prior years. Instead, the Department, including the military departments, monitors execution of our budget on a monthly basis and conducts a comprehensive midyear review each year to assess changes in requirements, program schedule changes, and pricing changes, to include shortfalls due to contract cost growth, unbudgeted pay raises, increased housing and subsistence costs, medical cost growth and other costs that could be attributed to changes in inflation. The Department addresses those shortfalls or savings by submitting reprogramming requests to the Congress for approval to transfer funds.

4. **Has DOD contracted with any non-DOD entities for the purpose of studying the effects of inflation on DOD?**
- a. **If so, please describe.**

Answer: No.

5. **Has DOD identified one senior official to lead inflation-related efforts?**
- a. **If so, please describe.**

Answer: As principal advisor to the Secretary of Defense for budgetary and fiscal matters, including financial management, budget formulation and execution, the Under Secretary of Defense (Comptroller) is the lead for inflation-related efforts.

6. **To what extent are Cost Assessment Data Enterprise personnel involved in efforts to identify necessary data elements and collection methods for inflation-related data?**

Answer: Inflation is not explicitly identified as a discrete data collection element in the data we collect from industry; however, the cost data (labor, material, and overhead) is collected in such a way that facilitates constructive dialogue with industry on all factors that drive costs to include inflation

7. What governance framework is in place for senior leadership to measure, track, and understand inflationary effects?

Answer: The governance framework used by the Department to measure inflationary effects on the budget is the Department's Planning, Programming, Budgeting and Execution (PPBE) process. As part of the PPBE process, inflation guidance received from the Office of Management and Budget is issued to Components to incorporate for programming and budget purposes, and then the Department conducts rigorous budget and execution reviews to include inflation impacts. During the budgeting process, the Department evaluates the impact of these inflation factors and makes the necessary budget adjustments prior to submitting the President's Budget to the Congress. During execution, the Department often submits reprogramming actions to the Congress to approve transfers to offset pricing changes.

8. Have inflationary effects been added as a module in senior leadership ADVANA dashboards and/or other decision support tools?

Answer: No, inflation is not tracked separately in our execution systems, primarily because inflation is only one of the factors that can impact the cost, schedule, and performance of our programs and activities.

9. Does departmental leadership have a regularized meeting schedule to discuss inflationary effects on departmental budgets?

Answer: The Comptroller meets regularly with the Deputy Secretary to discuss any major budget and execution issues, including inflation impacts. In addition, the Comptroller meets weekly with the Assistant Secretaries of the Military Departments for Financial Management to discuss and address budget and execution issues, which would include cost increases driven by inflation (e.g., fuel, health care cost growth, etc.). There are also regular interactions among career members of the Senior Executive Service on these subjects.

10. What was the actual observed inflation rate in FY 2021 for DOD, compared to the 2.1 percent assumed in the budget request?

Answer: The actual observed inflation, using the GDP (chained) price index for FY 2021, was 3.1%, which is 1.4 percentage points greater than the FY 2021 previously projected rate of 1.7% used for the FY 2022 President's Budget request.

11. What are the current actual and estimated inflation rates for fiscal year 2022, compared to the 2.3% assumed in the budget request?

Answer: The current Office of Management and Budget estimated inflation rate using the GDP (chained) price index growth for FY 2022 is 3.9%, which is 2.1 percentage points greater than the FY 2022 projected rate of 1.8%.

12. What are the observed and anticipated global inflationary effects on the following activities currently, for the fiscal 2021-time period, for the first six months of fiscal year 2022, for the final six months of fiscal year 2022, and for fiscal year 2023?

- a. **Military personnel basic pay**
- b. **Civilian personnel salaries**
- c. **Basic allowance for housing**
- d. **Fuel, all types**
- e. **Operations, other than fuel**
- f. **Maintenance**
- g. **Military construction**
- h. **Facilities sustainment, restoration and modernization**
- i. **Research, test, development, and evaluation**
- j. **Procurement**

Answer: The Department has observed quantifiable inflationary effects for Basic Allowance for Housing (BAH) and fuel, but the inflationary effects for other areas are less quantifiable due to the many factors that may influence price changes. For example, cost increases for certain military construction or repair projects can vary based on location, and can be influenced by material shortages, labor competition, and schedule changes.

For military basic pay and civilian salaries, the pay raises requested in the budget and, if different, enacted by Congress, are based, as required by law, on the Employment Cost Index, which is not strictly speaking a measure of inflation. Thus, these pay raises are not directly subject to changes in inflation, but rather reflect changes in private sector wage growth so that our military and civilian pay rates remain competitive.

For fuel, we have experienced significant price increases in FY 2022, primarily due to the spike in energy prices resulting from Russia's unprovoked invasion of Ukraine in February 2022, which occurred subsequent to the formulation of our FY 2023 budget. The Department has been forced to raise fuel prices by a total of \$3.4 billion in FY 2022 to reflect current market prices. Congress provided \$1.5B for additional fuel costs in the Department of Defense Appropriations Act, 2022, which addressed the additional costs known at that time.

For major investment programs the CAPE Cost Assessment Directorate and service cost directorates review and assess the development and application of inflation and price escalation forecasting methods within major program cost estimates. This includes reviewing and assessing specific program contract terms to understand the impact to the program cost estimate for any inflation/escalation impacts (refer to question 14). As changes in program cost estimates result from these assessments, the governance framework described in the answer to Question 7 is used to make the necessary budget adjustments.

At this time, the Department does not have a new estimate of FY 2023 price changes.

13. What are the observed and anticipated global inflationary effects on the following appropriations accounts currently, for the FY 2021 time period, for the first six months of fiscal year 2022, for the final six months of fiscal year 2022, and for fiscal year 2023?

- a. **Military personnel**
- b. **Operations and maintenance**
- c. **Research, development, test, and evaluation**
- d. **Procurement**
- e. **Military construction**

Answer: Please see the response for question #2, which provides the observed and anticipated GDP (chained) price index related inflationary effects in FY 2021, FY 2022 and estimated for FY 2023.

14. What major defense acquisition programs and middle-tier acquisition programs have seen the most and least inflation in the above time periods, and why do you believe these programs are experiencing these rates?

Answer: It is too early to tell. As FY 2022 progresses, the Department will be watching execution of funds closely. In the short term, it is expected that some large programs may be insulated from transient market pressures because of existing long-term purchase agreements between the Department and its prime and subcontractors and suppliers. Other programs where follow-on production currently is being negotiated are likely to show price escalation that reflects current market conditions. Most current fixed-price contracts do not have economic price adjustment (EPA) clauses (approximately 5% of DCMA administered contracts) that would allow firms to request price adjustments for inflation, and we have not seen many requests for equitable adjustment for inflation on contracts with or without EPA clauses. Vendors may seek to recoup losses from previous fixed price contracts in future bids.

Anecdotally, during a recent DoD visit, Government officials asked the Columbia program contractor how it was impacted by the sharp rise in steel prices. The contractor responded that long-term steel purchase agreements had been locked in at the lower prices before the rise, so as long as inflation does not endure too long, the effect of rising steel prices on that program would be minimal.

New contract negotiations are directly impacted by the uncertainty around inflation. The Department is working with all of the buying commands to ensure that there is a common understanding of when EPA clauses are appropriate to protect both industry and the government. It is essential that decisions about these clauses be made early enough in the negotiation process so that they can inform subcontract negotiations throughout the supply chain. Stabilized FY 2023 projected inflationary rates accounting for such things as COVID and supply chain disruptions will be updated as needed and released by the Comptroller in the budget information for use in the Services' annual estimates. Only then will we start to understand the impact of these effects.

- 15. How many service requests for prior approval reprogrammings related to inflationary effects is the Under Secretary of Defense (Comptroller) currently in receipt of? What is the total value of those reprogrammings?**

Answer: To date during FY 2022, there have been no prior approval reprogramming requests related to inflationary effects for the Department.

- 16. How many Service requests for internal reprogrammings related to inflationary effects is the Under Secretary of Defense (Comptroller) currently in receipt of? What is the total value of those reprogrammings?**

Answer: To date during FY 2022, there have been no internal reprogrammings related to inflationary effects for the Department.

- 17. Has DOD received any requests for equitable adjustment based on inflationary effects? If so, please provide a list or table of such requests, with associated percentage adjustments by contract and the associated current disposition of such requests.**

Answer: DoD has not received any requests for equitable adjustments based on inflationary effects in FY 2022.

- 18. To what extent has DOD authorized contracting officers to enter into negotiations for economic price adjustments (EPA) or other contract modifications to account for inflation?**
- a. If EPA authorization has not been widely approved and encouraged, why not, and what is the Department's plan to exercise such authorities?**

Answer: For new contracts, contracting officers already have the necessary authority to enter into flexibly priced contracts as appropriate and to negotiate economic price adjustments on fixed price contracts; therefore, no authorization is needed from the Department.

For existing contracts, the terms of each contract set forth the rights of the parties. If the contract does not provide for an adjustment due to inflation, there would need to be a contract bilateral modification to incorporate the EPA clause. However, certain contracts are flexibly priced and may allow for increased cost recognition due to inflation, as matter of course and without adjustment to contract terms.

DoD's "Guidance on Using Incentives and Other Contract Types" (Defense Federal Acquisition Regulation Supplement (DFARS) Procedures, Guidance and Instruction 216.104) informs contracting officers about the circumstances that indicate when EPA should be used. This includes where market or labor conditions are projected to be unstable during an extended contract performance period and risk stems from Industry-wide contingencies beyond the contractor's control.

- 19. What changes in behavior is DOD observing from the defense industrial base due primarily to the inflation spike, including but not limited to: increased inability to obtain quotes for future labor rates or material costs; increased "no-bid " positions on solicitations; higher fixed-price contract bids; and a preference for or condition of only cost-plus contracting terms?**

Answer: The Department is just beginning to receive inputs from the DoD buying activities about changes in behavior. Examples include: a request for an economic price adjustment clause for specialty metals; expressed concerns about entering into long-term agreements; and a request to cancel a long-term contract.

- 20. What is the methodology used by DOD and the Office and Management and Budget (OMB) to determine the inflationary rates by appropriation account in Chapter 5 of the fiscal year 2022 Green Book?**

Answer: The Department uses DoD deflators that are calculated using the GDP (chained) price index for purchases, excluding pay and fuel, applied to the outlay rates for each appropriation. For example, for a one-year operation and maintenance account with outlays projected for three years, inflation impacts will be estimated for years two and three to determine the total inflation for the budget authority for year one. Additionally, the military and civilian pay raise impacts are included in the rates, as well as the projected fuel changes.

- a. What measure of inflation does DOD/OMB use to measure inflationary effects on service member benefits/buying power? If this measure is not closely related to CPI-U or PCE, why are those measures inapplicable?**

Answer: The Department uses a wide array of measures of inflation to administer specific programs and assess inflationary impacts on service members, including housing rental surveys, the U.S. Department of Agriculture (USDA) Liberal Food Cost Indicator, the Consumer Price Index for medical care services and commodities (CPI-U Medical), National Health Expenditures, and the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W).

- Rental Surveys from the summer prior to implementation are used to determine service members' Basic Allowance for Housing (BAH).
- The USDA Liberal Food Cost Index is used to develop rate increases required for Basic Allowance for Subsistence.
- Both CPI-U Medical and National Health Expenditures are used to determine cost growth for in-house and private sector care.
- Finally, CPI-W is used for accrual rate development for the Military Retirement Fund, and for the calculation of cost of living allowances for military retirement benefits, which are paid from the Military Retirement Trust Fund and are not included in the defense budget.

Using these economic measures of inflation provides the flexibility to assess and respond to economic impacts relevant to particular programs.

21. How has the current inflation spike changed the outlook for budget execution in the years that would be in the fiscal year 2022 FYDP?

- a. What steps are you taking or considering taking to mitigate the current inflation spike and the compounding effect it will have in future years?**

Answer: The Department developed the FY 2023 Future Years Defense Program (FYDP) using economic assumptions provided in December 2021 by the Office of Management and Budget. The FYDP includes the effects of higher GDP (chained) price index growth in FY 2021 as well as modified higher GDP (chained) price index growth in FY 2022 and FY 2023.

As the Comptroller has testified to Congress and described when the Department released the FY 2023 budget request, the Department, with the support of the President and the Office of Management and Budget, added approximately \$20 billion per year to the Department's topline profile over the FY 2023-2027 FYDP, compared to the profile in the FY 2022 budget. Of that amount, approximately \$14 billion per year reflects updated pricing for the purchase of goods and services, as reflected in the response to question 2, and the other \$6 billion per year addresses higher pay and compensation costs described in the response to question 12.

22. Has DOD developed any legislative proposals that would help the department respond to inflation proactively or within the year of execution, instead of after the fact?

Answer: The Department has not developed any legislative proposals specific to inflation.

23. What additional authorities should Congress consider providing in the FY 2023 NDAA that would be helpful to mitigate the current inflation spike and projected impacts?

Answer: The Department has not identified any required additional authorities required for the FY 2023 NDAA to address the current inflation spike. However, if authorities are needed, the Department will work with the President and Congress. Should this budget request, or any budget request, be underfunded with respect to inflation, to fully mitigate the impact of inflation Congress would have to provide the Department with additional resources. By contrast, if the Congress increases the topline but directs all the additional resources toward specific programs or program increases not requested by the Department, as was the case with the National Defense Authorization Act for Fiscal Year 2022, those increased budgetary resources would not mitigate the impact of higher inflation.